

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Daucher and Rod Pacheco Analyst: Kimberly Pantoja Bill Number: AB 4X
Related Bills: See Legislative History Telephone: 845-4786 Amended Date: 02/09/01
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Emission Reduction Credits Purchased for Electrical Generating Facilities Credit

SUMMARY

This bill would create a 100% tax credit for the purchase of emission reduction credits for an electrical generating facility.

SUMMARY OF AMENDMENT

The February 9, 2001, amendments replaced the bill language as introduced January 9, 2001, with the proposed credit for the purchase of emission reduction credits for electrical generating facilities.

This is the department's first analysis of the bill.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to utilize the tax system to encourage electrical generating facilities to purchase emission reduction credits which would allow them to operate for extended hours. The purpose is also to provide an incentive for these electrical generating facilities to sell the electricity they generate to purchasers within California before selling to out-of-state consumers.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective upon enactment. However, this bill specifies that it would be operative for taxable years beginning on or after January 1, 2002.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Executive Order D-24-01, signed by Governor Davis on February 8, 2001, orders the Air Quality Resources Board (Board) to "establish an emissions reduction credit bank using emissions reductions from all available sources. Such credits shall be made available through the Board to powerplant peaking sources that need emissions offsets in order to add new or expanded peaking capacity for

Board Position:

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Department Director

Date

G. Alan Hunter for GHG

04/19/2001

the summer peak season in 2001." Credits shall be provided to facilities at up to the market rate for emissions reduction credits. In the case of a powerplant that agrees to sell its power under contract to the Department of Water Resources, the State of California will make available where necessary the required emissions credits at up to a 50% reduction. In order to maximize the amount of electrical generating capacity that can be created with available funding, emissions reduction credits for new generation capacity shall be made available to facilities where necessary and available. Proceeds from the sales of these emissions reduction credits shall be made available to fund emissions reduction programs in the air district where the new or expanded facility is located. It was further ordered that the Board shall make its remaining appropriated funds immediately available for the purchase of emissions offset credits for its emissions reduction credit bank or that of any district.

Both state and federal laws allow a deduction for all ordinary and necessary expenses of a trade or business, including expenses relating to energy conservation measures.

Both state and federal laws provide various tax credits designed to provide tax relief for taxpayers that must incur certain expenses (e.g., renter's credit) or to influence behavior, including business practices and decisions (e.g., research credits).

Neither state nor federal laws have a credit comparable to the credit proposed by this bill.

THIS BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would create a tax credit equal to 100% of the price paid or incurred by a qualified person or taxpayer for emission reduction credits purchased for an electrical generating facility.

The bill defines "qualified person" or "taxpayer" as any person or corporation that does both of the following:

- owns or operates a facility in this state that generates electricity; and
- agrees to offer to sell the electricity generated by its facility to purchasers within this state before offering to sell that electricity to purchasers outside this state.

Any excess credit may be carried over until exhausted.

IMPLEMENTATION CONSIDERATIONS

The bill does not define "emission reduction credits," or "electrical generating facility." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of the credit.

This bill uses a sales and use tax term "qualified person" rather than the income tax term "qualified taxpayer" in the PITL portion of this credit. It would be preferable to change the reference from qualified person to qualified taxpayer.

The bill does not specify a method for the department to verify that the electricity generated by the facility was first offered to purchasers within California before it was offered to purchasers outside the state.

This bill does not limit the number of years for the carryover. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover is allowed. Recent credits have been enacted with a carryover limit since experience shows credits are typically used within eight years of being earned.

LEGISLATIVE HISTORY

AB 94 (Daucher and Rod Pacheco, 2001/2002) contains the same language as in this bill and is currently in the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

Review of Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York laws found no comparable tax credits or deductions. These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

Once the implementation concerns are resolved, this bill is not expected to impact the department's costs significantly.

ECONOMIC IMPACT

Tax Revenue Estimate

Potential revenue losses would be significant, in the \$10-\$50 million range annually beginning in 2002-03. It is speculative at this time about when new or expanded facilities would come on line and the extent to which taxpayers would have sufficient state tax liabilities to absorb credits worth millions of dollars.

This analysis assumes that generators of electricity can claim the credits even if the cost of emission reduction credits is passed on to purchasers/users of the power. Total potential tax credits could amount to \$50 million in any given year with actual applied credits, based on available tax liabilities, in the \$10 to \$50 million range.

Tax Revenue Discussion

The revenue impact of this bill would be determined by the amount of costs incurred by "qualified persons" or "taxpayers" in acquiring "emission reduction credits" for electrical generating facilities, and the amount of tax credits that could be applied to reduce tax liabilities.

Once created, emission reduction credits may be banked with the local air quality management district for future use by the source that generated them, used concurrently to offset new projects, or sold to other sources for use as mitigation. Under present conditions, the market place determines the fair value of emission reduction credits that are sold. According to sources at the Air Resources Board, new or modified electrical generating facilities have typically incurred costs in the range of \$5 million to \$10 million for emission reduction credits. Under this proposal, the market value of emissions reduction credits would likely inflate. There is also the potential for abuse as one subsidiary could sell credits to another related subsidiary.

The Energy Commission indicates that a total of ten power plants currently under construction are expected to come on line within the next three years: four in 2001, and three each in 2002 and 2003. An additional 15 are currently in the licensing process with an additional ten expected to begin the licensing process within coming months. One of the ten is government owned. Construction of new power plants typically requires about 24 months to complete. Due to California's current energy challenge, if the number of power plants that come on line doubles beginning in 2003, total credits would be \$50 million annually assuming an average cost for emission reduction credits of \$8 million per new power plant and costs are incurred when a facility goes on line.

CONSTITUTIONAL CONSIDERATION

The bill requires that taxpayers agree to offer electricity to Californians first, regardless of price, which appears to be a direct interference with interstate commerce. This requirement is apparently applicable regardless of the selling price. For example, if a Californian wants to buy electricity for \$2/megawatt, but the taxpayer can sell it to another state for \$4/megawatt, the taxpayer has to sell the electricity to California for \$2/megawatt to be allowed the credit.

ARGUMENTS/POLICY CONCERNS

The bill does not provide for the recapture of the credit if the unused credits are sold. It would be possible for a facility to purchase more credits than needed and claim the credit, then resell the credits to a cannery for instance. Requiring the facility to prove that they used the emission reduction credits may reduce this concern.

By allowing the taxpayer to claim the proposed credit in addition to any deduction allowed for the same expenses, this bill would allow taxpayers to claim multiple tax benefits for the same item of expense.

Credits generally are provided as a percentage of amounts paid or incurred. This bill would allow a 100% credit, which is unprecedented.

This bill does not specify a repeal date. Credits typically are enacted with a repeal date to allow the Legislature to review the effectiveness of the credit.

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